

BUREAU OF FINANCIAL INSTITUTIONS
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Real Estate Appraisals

DISCUSSION

During the past 12-18 months, the Maine Bureau of Financial Institutions has noted an increase in the number of violations of 12 CFR Section 323 – Appraisals of FDIC Rules and Regulations cited in both Bureau and Federal Deposit Insurance Corporation reports of examination. The violations can be divided into two basic categories:

- 1 Failure to obtain an appraisal as required by 12 CFR Section 323.3; and,
- 2 Failure to obtain an appraisal or an evaluation that meets the requirements of 12 CFR Section 323.4 – Minimum Appraisal Standards.

Since 12 CFR Section 323 has been in effect for approximately 10 years, the increases in the number of violations of the regulation is quite concerning. Typical violations are more specifically discussed in the following paragraphs.

Violations of 12 CFR Section 323.3

This section of the regulation sets forth the circumstances for which an appraisal is required and the exceptions to the general requirement. Violations of this section typically involve a misinterpretation or an overly liberal interpretation of the exceptions by institutions, resulting in failure to obtain an appraisal when the underlying credit approval did not support the exception. Common errors involve Section 323.3(a)(2), where real estate is taken as collateral in an abundance of caution, and Section 323.3(a)(5), where the loan is a business loan of less than \$1 million and is not dependent upon the sale of, or rental income derived from, real estate as the primary source of repayment. Competitive pressure is sometimes cited as the reason that institutions do not obtain appraisals that are required by the regulation. Although competitive pressure may cause an institution not to pass on the cost of an appraisal to a customer, it is not a legitimate reason for not obtaining an appraisal as required by the regulation.

Another common violation involves Sections 323.3(b), which directs institutions to obtain an appropriate evaluation of real property for which an appraisal is not required under Section 323.3(a)(1), (5), or (7). In many instances, institutions are not obtaining an evaluation that conforms to the requirements for such evaluations contained in the Interagency Policy Statement on Appraisal and Evaluation Guidelines¹.

Violations of 12 CFR Section 323.4

This section of the regulation sets forth minimum standards for appraisals. These minimum appraisal standards require that the appraisal:

1. Conform to generally accepted appraisal standards as evidenced by the Uniform Standards of Professional Appraisal Practice (USPAP) promulgated by the Appraisal Standards Board;
2. Be written and contain sufficient analysis to support the institution's decision to engage in the transaction;
3. Analyze and report appropriate deductions and discounts;
4. Be based upon the definition of market value as contained in the regulation; and,
5. Be performed by state-licensed or state-certified appraisers in accordance with the regulation.

Common violations or exceptions to this section include: a) appraisers incorrectly applying the departure rule to standards for which departure is not permitted under the departure rule; b) omitting an approach to value that typical practice and peers would require; and, c) failure to include the current market value of the property in its as is condition (required for all assignments for use by a federally-insured depository institution, Statement -10 of USPAP). The acceptance of appraisals that do not conform to the requirements of Section 323.4 indicates deficiencies in an institution's appraisal review function and a lack of understanding of USPAP.

RECOMMENDED CORECTIVE ACTION

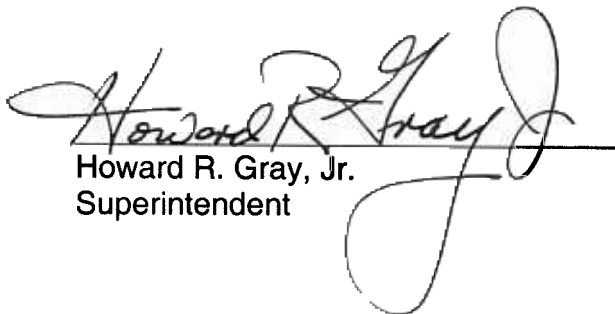
Institutions are encouraged to review their appraisal policies and practices to assure compliance with 12 CFR Section 323. Specifically, institutions should assess their policies and practices and make the necessary improvements with respect to the following:

1. Review and evaluation of appraisals;
2. Selection of qualified appraisers;
3. Independence of appraisers;
4. Evaluation or appraisal for transactions that are otherwise exempt from the regulation; and,

See FDIC Financial Institution Letter 74-94.

5. Internal controls to assure compliance with the institution's policy and 12 CFR Section 323.

In addition to 12 CFR Part 323, institutions are encourage to consult: 1) the Interagency Appraisal and Evaluation Guidelines¹ and 2) FDIC Financial Institution Letter 20-2001 regarding the Appraisal Foundation's Appraisal Standard Statement #10, *"Assignments for Use by a Federally Insured Depository Institution in a Federally Related Transaction"* in conducting a review of their appraisal policies and practices.



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